

Internal Revenue Service
memorandum

date: APR 12 1991

to: District Counsel, Laguna Niguel W:LN
Attn: Tom Travers

from: Special Counsel (International) CC:INTL

subject: [REDACTED]

This is a follow up to our conversation last week. We discussed whether I.R.C. § 482 could be applied to support an adjustment to [REDACTED], a U.S. corporation. Also, we discussed whether we could treat [REDACTED], a [REDACTED] corporation, as engaged in the United States through a permanent establishment and subject it to tax under I.R.C. § 882.

I have reconstructed the facts from my notes. They are as follows:

[REDACTED] is a [REDACTED] national. He owns [REDACTED]% of the stock in [REDACTED], a [REDACTED] corporation and [REDACTED]% of [REDACTED], a domestic corporation. [REDACTED] owns the remaining [REDACTED]% of [REDACTED].

[REDACTED] is engaged in the manufacture of [REDACTED] in [REDACTED]. In its [REDACTED] taxable years [REDACTED] purchased [REDACTED] from [REDACTED] and sold them as part of a unit to two U.S. limited partnerships. Each of the U.S. partnerships has a [REDACTED]% U.S. general partner and a [REDACTED] corporation as a [REDACTED]% limited partner. The [REDACTED] corporate limited partners are publicly held. As far as we know, no linkage exists between the [REDACTED] corporate limited partners and [REDACTED] or [REDACTED].

The [REDACTED] purchased by [REDACTED] are a component of a unit that (in theory) is used to [REDACTED]. The other key components are the [REDACTED] and the [REDACTED]. The [REDACTED] is what the [REDACTED] is mounted on and is secured to the ground. The [REDACTED] are attached to the [REDACTED].

With respect to the [REDACTED] sold by [REDACTED] to the U.S. partnership, [REDACTED] purchased the [REDACTED] and [REDACTED] in the United States and resold them to [REDACTED]. Presumably [REDACTED] assembled the components to make the units which it sold to the U.S. partnership.

The sales contracts between [REDACTED] and the U.S. partnership provided for installation of the [REDACTED] by [REDACTED]. All elements of the sales contracts were guaranteed by [REDACTED].

008106

As discussed previously potential issues exist under I.R.C. § 482 and 882. Further factual development is necessary before any conclusions can be drawn. Below are some suggestions you may want to pass along to the international examiner. I will be in your office on April 18th and will be available to discuss any aspect of this case with you and the international examiner.

I.R.C. § 482

Potential I.R.C. § 482 issues exist with respect to the prices charged [REDACTED] by [REDACTED] for all components of the [REDACTED].

The regulations require us to search for comparables when determining whether sales of tangible personal property to related parties are at arm's length.

The IE should attempt to find out whether [REDACTED] makes sales of identical [REDACTED] to unrelated parties in the United States (internal comparables).

If this information cannot be obtained, the IE should identify whether any unique manufacturing intangibles are associated with the production of the [REDACTED]. By unique, I am referring to something akin to state-of-the-art technology which would differentiate [REDACTED] from a [REDACTED] manufactured by a competitor. If no such intangibles exist the IE should determine whether any significant marketing intangibles e.g., trademark are owned by [REDACTED].

Assuming the IE finds neither unique manufacturing intangibles nor significant marketing intangibles he should look for other companies who purchase similar (i.e., [REDACTED], etc.) [REDACTED] from unrelated manufacturers (external comparables). An economist may be necessary to value the differences if the [REDACTED] used as the external comparables are not physically identical to the [REDACTED] sold by [REDACTED] to [REDACTED] or the circumstances of the sales differ enough to require an adjustment.

Since the [REDACTED] and [REDACTED] are purchased by [REDACTED] in the United States and resold to [REDACTED], comparables must exist for these items.

The IE should determine each function or service, performed by [REDACTED] with respect to the sale, assembly and installation of the [REDACTED] and also each element of risk assumed by [REDACTED] e.g., warranty.

If we find that [REDACTED] was performing functions, providing services or assuming risks with respect to the sale, assembly and

installation of the [REDACTED] that an unrelated vendor would not undertake, we may have an additional I.R.C. § 482 issue in the form of allocating a fee for services from [REDACTED] to [REDACTED] or reducing [REDACTED] cost of goods sold.

Permanent Establishment

The [REDACTED] Treaty permits the United States to tax all U.S. source income of [REDACTED] if [REDACTED] has a permanent establishment. I.R.C. § 894 will limit the United States to taxing income effectively connected to the permanent establishment.

The IE should find out all circumstances surrounding the sales of each component by [REDACTED] to [REDACTED]. This includes:

Where did title and risk of loss pass with respect to each component?

Who negotiated the sale of each of the components by [REDACTED] to [REDACTED]?

Where did the negotiations take place?

Was there a contract?

Who signed for [REDACTED] and for [REDACTED]. Where was the contract signed?

Does [REDACTED] have employees in the United States? If yes, identify them and what each person does?

Are employees of [REDACTED] in any way involved in the purchase of the [REDACTED] and/or [REDACTED]? If so, describe the circumstances.

I will be glad to elaborate on all of this when I am in Laguna next week. Suffice it to say there is plenty for the IE to do between now and then! See you on the 18th.


KIM A. PALMERINO

cc: John T. Lyons
Christine Halphen
Bill Bonano